

# **Report of the Director of Finance to the meeting of the Governance and Audit Committee to be held on 23<sup>rd</sup> March 2023**

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## **Subject:**

**Treasury Management Strategy 2023-24**

## **Summary statement:**

**This report shows the Council's 2023-24 Treasury Strategy and Prudential Indicators**

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**Portfolio:**  
**Corporate Services**

**Overview & Scrutiny Area:**  
**Corporate Services**

# 1. INTRODUCTION

## 1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low-risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The contribution the treasury management function makes to the Council is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

*"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day-to-day treasury management activities.

## 1.2 Reporting requirements

### 1.2.1 Capital Strategy

The CIPFA 2021 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:

- a high-level long-term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of the capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite. This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former.

## 1.2.2 Treasury Management reporting

The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

- a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
  - the capital plans, (including prudential indicators);
  - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
  - the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
  - an investment strategy, (the parameters on how treasury investments are to be managed).
  
- b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.
  
- c. **An annual treasury report** – This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

## 1.2.3 Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Governance and Audit Committee.

## 1.2.4 Quarterly reports

In addition to the three major reports detailed above, from 2023-24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to Full Council/Board but do require to be adequately scrutinised. It is proposed this role is undertaken by the Executive Committee as part of the Quarterly Finance Reports.

## 1.3 Treasury Management Strategy for 2023-24

The strategy for 2023-24 covers two main areas:

### Capital issues

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

### Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, Department of Levelling Up Housing and Communities (DLUHC) Investment Guidance, DLUHC MRP Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code.

## 1.4 Training

The CIPFA Treasury Management Code requires the responsible officer (in Bradford the Director of Finance) to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny.

Furthermore, a new introduction within the Code for 2023-24 states that they expect “all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making.”

The scale and nature of this will depend on the size and complexity of the organisation’s treasury management needs. Organisations should consider how to assess whether treasury management staff and board/ council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

As a minimum, authorities should carry out the following to monitor and review knowledge and skills:

- Record attendance at training and ensure action is taken where poor attendance is identified.
- Prepare tailored learning plans for treasury management officers and board/council members.
- Require treasury management officers and board/council members to undertake self-assessment against the required competencies (as set out in the schedule that may be adopted by the organisation).
- Have regular communication with officers and board/council members, encouraging them to highlight training needs on an ongoing basis.”

In further support of the revised training requirements, CIPFA’s Better Governance Forum and Treasury Management Network have produced a ‘self-assessment by members responsible for the scrutiny of treasury management’, which is available from the CIPFA website to download.

Training has been undertaken by Members on the 24<sup>th</sup> November 2022 led by an external trainer. and further training will be arranged as required. To continue to meet these new requirements an assessment will be made and training will be arranged to meet any training requirement identified during 2023-24.

The training needs of treasury management officers are periodically reviewed. A formal record of the training received by officers central to the Treasury function will be maintained. Similarly, a formal record of the treasury management/capital finance training received by Members will also be maintained.

## **1.5 Treasury management consultants**

The Council uses Link Group, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

## 2. CAPITAL PRUDENTIAL INDICATORS

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans. These indicators as per the Capital Investment Plan include previous years' actual expenditure, forecast expenditure for this current year 2022-23 and estimates for the next four-year period.

### 2.1 Capital expenditure and financing

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

**Table 1: Capital Plan Expenditure**

<b>Capital expenditure</b>	<b>2021-22 Actual £m</b>	<b>2022-23 Estimate £m</b>	<b>2023-24 Estimate £m</b>	<b>2024-25 Estimate £m</b>	<b>2025-26 Estimate £m</b>	<b>2026-27 Estimate £m</b>
General Fund	-	-	232	203	76	134
HRA*	-	-	5	10	10	4
<b>Total</b>	<b>104</b>	<b>191</b>	<b>237</b>	<b>213</b>	<b>86</b>	<b>138</b>

\*Separate HRA only applies from 01-04-2023

The proposed CIP includes £865m of capital investment in the District (£836m General Fund and £29m Housing Revenue Account). The Executive, at its meeting of November 1 2022, approved the opening of a Housing Revenue Account (HRA) in the financial year 2023-24. The HRA is a ring-fenced account which ensures that council housing does not subsidise, or is itself subsidised, by other local services paid for from the general fund. HRA capital expenditure is therefore recorded separately. The HRA business plan is being developed and there will be further updates to the Housing Capital Plan and Prudential Indicators once this has been approved.

The capital expenditure shown above excludes other long-term liabilities, such as Private Finance Initiative (PFI) and leasing arrangements which already include borrowing instruments.

Table 2 below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

**Table 2: Capital funding**

	<b>2021-22 Actual £m</b>	<b>2022-23 Estimate £m</b>	<b>2023-24 Estimate £m</b>	<b>2024-25 Estimate £m</b>	<b>2025-26 Estimate £m</b>	<b>2026-27 Estimate £m</b>
Total Capital Spend	104	191	237	213	86	138
Capital Spend not funded from borrowing	70	108	133	121	48	78
<b>Capital spend funded from borrowing</b>	<b>34</b>	<b>83</b>	<b>104</b>	<b>92</b>	<b>38</b>	<b>60</b>

The borrowing need for capital expenditure in 2023-24 is currently expected to be £104m. This will however change if there is a revision to the spending profile of the capital plan.

## 2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities (e.g., PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £147m of such schemes within the CFR.

**Table 3: Capital Financing Requirement**

	2021-22 Actual £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m	2026-27 Estimate £m
<b>Non-HRA</b>	-	-	819	883	893	928
<b>HRA*</b>	-	-	35	37	37	33
<b>Capital Financing Requirement</b>	<b>709</b>	<b>773</b>	<b>854</b>	<b>920</b>	<b>930</b>	<b>961</b>
<b>Movement in CFR</b>		<b>64</b>	<b>81</b>	<b>66</b>	<b>10</b>	<b>31</b>

### **Movement in CFR represented by**

Net financing need for the year (above)		<b>83</b>	<b>104</b>	<b>92</b>	<b>38</b>	<b>60</b>
Less MRP/VRP and other financing movements		-19	-23	-26	-28	-29
<b>Movement in CFR</b>		<b>64</b>	<b>81</b>	<b>66</b>	<b>10</b>	<b>31</b>

\*Separate HRA only applies from 01-04-2023

## 2.3 Liability Benchmark

A third and new prudential indicator for 2023-24 is the Liability Benchmark (LB). The Liability Benchmark, based on current capital plans and cash flow assumptions, therefore gives the Council an indication of how much it needs to borrow, when it is likely to need to borrow, and where to match maturities to its planned borrowing needs. The liability benchmark makes no assumption about the level of future prudential borrowing in unknown capital budgets.

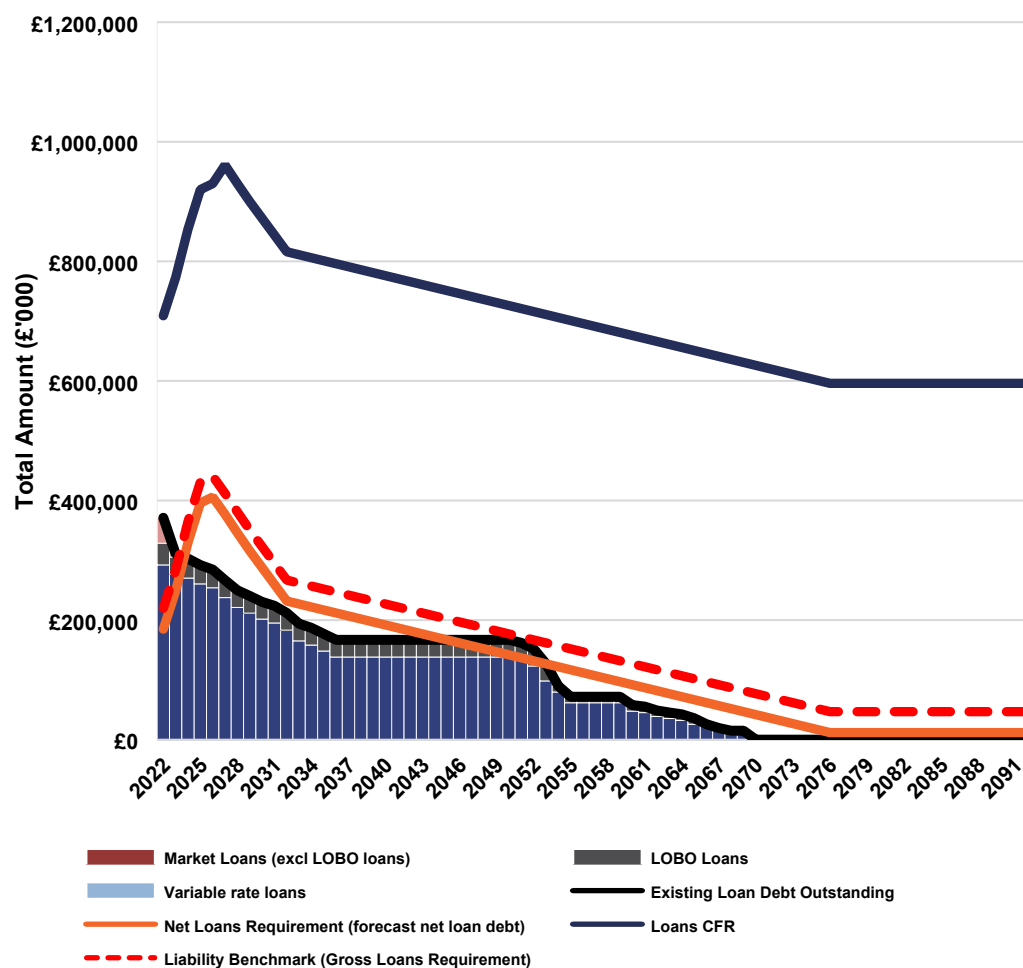
There are four components to the LB: -

1. **Existing loan debt outstanding:** the Council's existing loans that are still outstanding in future years.
2. **Loans CFR:** this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned MRP.

3. **Net loans requirement:** this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned MRP and any other major cash flows forecast.
4. **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.

The purpose of this prudential indicator is to compare the Council's existing loans outstanding against its future need for loan debt; the liability benchmark (the red dotted line). If the loans outstanding are below the liability benchmark (the red dotted line), the existing debt outstanding is less than the loan debt required, and the Council will need to borrow in the future to meet the shortfall. If the loans outstanding are above the liability benchmark (the red dotted line), the Council will have more debt than it needs based on current plans and the excess will have to be invested.

**Graph 1 Liability Benchmark**



As can be seen from the Council's liability benchmark graph, the loans outstanding, CFR, liability benchmark and net loans requirement broadly follow the same trend lines. Based on the CFR position and loans outstanding at 31st March 2022 we see the Council's under borrowed position. In the next 5 years the CFR increases in line with prudential borrowing expectations to fund increases to the capital programme before gradually starting to decrease. The liability benchmark and net loans requirement also increase to indicate the additional borrowing need before gradually starting to decrease. Existing loans start to decrease as maturities occur and loans are paid back.



Taking into account the current under borrowed position and with no assumptions on future borrowing requirements beyond the current capital programme, the gap between the CFR and loans outstanding remain broadly similar over the term indicated on the liability benchmark graph. When taking into account the liability benchmark and net loans requirement this gives an indication of how much future loan debt may need be taken and on what maturity term to assist with long term planning and reduce risk. Actual future debt taken may not exactly follow the liability benchmark as this is only a guide at a specific point in time, and one of several considerations when drawing down long term debt, to be determined by the S.151 Officer.

## **2.4 Minimum revenue provision (MRP) policy statement**

In accordance with the Local Government Act 2003 the Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

DLUHC regulations have been issued which require the Full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The policy, as approved by Executive 21 February 2023 and Full Council 23 February 2023, is set out in Appendix 2.

An external review of the Council's MRP policy was recently undertaken. The objective of the review was to provide the Council with an independent check that the MRP Strategy and Policy are fit for both the current and future spending plans. It also provides the necessary challenge to ensure that any potential options are not missed when considering the capital financing decisions for new capital expenditure ensuring that the provision remains prudent and compliant with statutory guidance.

Full Council approved the following MRP statement amendment for the 2022-23 and 2023-24 financial years:

- Change the calculation of MRP for supported borrowing from a straight line method to an annuity basis over 36 years (the remaining average life of the overall asset base).
- Change the calculation of MRP for unsupported borrowing from an asset life straight line basis to an asset life annuity basis using an annual weighted average calculation. Estimated asset life periods will be determined under delegated powers.
- Change the calculation of MRP for PFI contracts from an asset life straight line basis to an asset life annuity basis.

The main elements of the policy set out in Appendix 2 are set out below:

- Pre 2008 debt, which cannot be distinguished against specific assets, was being repaid over 50 years on an equal instalment basis. This has been amended from 2022-23 to an asset life annuity basis.
- All other debt and PFI liabilities is amended to be repaid on an annuity asset life basis: as determined by the expected lifespan of each individual asset.
- The policy also provides some discretion to the Section 151 officer in determining debt repayments. However, this is subject to the relevant scheme meeting targets.

- MRP in respect of finance leases will equal the repayment amount for the year.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.

### 3. BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

#### 3.1 Current portfolio position

The overall treasury management portfolio as at 31<sup>st</sup> March 2022 and as at 31<sup>st</sup> January 2023 are shown below for both borrowing and investments.

**Table 4: Treasury Portfolio**

	<b>Actual 31 March 2022</b>	<b>Actual 31 March 2022</b>	<b>Current 31 January 2023</b>	<b>Current 31 January 2023</b>
	<b>£m</b>	<b>%</b>	<b>£m</b>	<b>%</b>
<b>Treasury Investments</b>				
Banks	103.5	55	20	45.2
Building Societies	0	0	0	0
DMADF (H M Treasury)	5.0	3	0	0
Money Market funds	77.6	42	24.2	54.8
<b>Total Treasury Investments</b>	<b>186.1</b>	<b>100</b>	<b>44.2</b>	<b>100</b>
<b>Treasury External Borrowing</b>				
Other	42.6	11	36.7	9
PWLB	292.3	79	331.8	82
LOBOs	36.2	10	36.2	9
<b>Total external borrowing</b>	<b>371.1</b>	<b>100</b>	<b>404.7</b>	<b>100</b>
<b>Net Treasury Investments / (borrowing)</b>	<b>(185.0)</b>		<b>(360.5)</b>	

The Council's forward projections for borrowing are summarised over. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

The Council is forecast to hold around £594 million of external borrowing and other long-term liabilities as at 31 March 2023. This is analysed in Table 5.

**Table 5: Borrowing Projection**

	2021-22 Actual £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m	2026-27 Estimate £m
<b>External Debt</b>						
Debt at 1 April	334.4	371.1	455.0	546.0	641.0	663.0
Expected change in Debt	36.7	83.9	91.0	95.0	22.0	51.0
Other long-term liabilities (OLTL)	154.9	146.9	139.0	130.5	121.9	112.0
Expected change in OLTL	-8.0	-7.9	-8.5	-8.6	-9.9	-10.5
Actual gross debt at 31 March	<b>519.6</b>	<b>594.0</b>	<b>676.5</b>	<b>762.9</b>	<b>775.0</b>	<b>815.5</b>
The Capital Financing Requirement	709.2	<b>773.0</b>	<b>854.0</b>	<b>920.0</b>	<b>930.0</b>	<b>961.0</b>
Under / (over) borrowing	<b>189.6</b>	<b>179.0</b>	<b>177.5</b>	<b>157.1</b>	<b>155.0</b>	<b>145.5</b>

Table 5 shows that, based on the capital programme (paragraph 2.1), additional borrowing from PWLB will be required of £91m in 2023-24, £95m in 2024-25 and £22m in 2025-26 if capital programme expenditure matches the anticipated spending profile. The borrowing requirement is a key driver of the borrowing strategy. The timing of any additional borrowing given the amounts indicated in the table above will be closely monitored. Members will recall that capital spending plans have been reprofiled year on year and it is possible that the trend could be repeated in 2023-24 and future years.

The relative mix of future internal and external borrowing will be considered in conjunction with advice from the Council's external treasury management advisor, noting that provision has been made in the updated Council budget plan revenue resource assumptions to accommodate a continued future mix of internal and external borrowing.

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2023-24 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

The Council should include within the forecast gross borrowing figures in Table 5, any debt that relates to commercial activities / non-financial investments. The Council has no external debt for commercial activities/non-financial investments included in the gross borrowing figures in Table 5.

Salix Finance Limited provides interest free Government funding to the public sector to improve their energy efficiency, reduce carbon emissions and lower energy bills. The Council has taken the opportunity to secure £19.1 million interest free loans to part fund the £45 million approved street lighting replacement scheme in the Council's approved capital plan. To date, the Council has received £8.6m from Salix and repaid £0.3m.

### 3.2 Treasury Indicators: limits to borrowing activity

**The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

**The authorised limit for external debt.** This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit.

**Table 6: Operational Boundary and Authorised Limit**

	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m
Operational boundary	840	860	930	940
Authorised limit	860	880	950	960

### 3.3 Interest Rate Forecast

The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts on 7<sup>th</sup> February 2022. These are forecasts for certainty rates, gilt yields plus 80 bps.

**Table 7: Interest rate Forecast**

Link Group Interest Rate View 07.02.23		Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
<b>BANK RATE</b>		4.25	4.50	4.50	4.25	4.00	3.75	3.25	3.00	2.75	2.75	2.50	2.50	2.50
3 month ave earnings		4.30	4.50	4.50	4.30	4.00	3.80	3.30	3.00	2.80	2.80	2.50	2.50	2.50
6 month ave earnings		4.40	4.50	4.40	4.20	3.90	3.70	3.20	2.90	2.80	2.80	2.60	2.60	2.60
12 month ave earnings		4.50	4.50	4.40	4.20	3.80	3.60	3.10	2.70	2.70	2.70	2.70	2.70	2.70
5 yr PWLB		4.00	4.00	3.90	3.80	3.70	3.60	3.50	3.40	3.30	3.20	3.10	3.10	3.10
10 yr PWLB		4.20	4.20	4.10	4.00	3.90	3.80	3.60	3.50	3.50	3.40	3.30	3.30	3.20
25 yr PWLB		4.60	4.60	4.40	4.30	4.20	4.10	3.90	3.80	3.70	3.60	3.50	3.40	3.40
50 yr PWLB		4.30	4.30	4.20	4.10	3.90	3.80	3.60	3.60	3.40	3.30	3.20	3.20	3.10

- The Link central forecast reflects a view that the Monetary Policy Committee (MPC) will be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. This has happened throughout 2022 but the Government's continued policy of emphasising fiscal rectitude will probably mean Bank Rate will not need to increase to further than 4.5%.
- Further in to future years, Link anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.
- The Consumer Price Index (CPI) measure of inflation looks to have peaked at 11.1% in Q4 2022 (currently 10.5%). Despite the cost-of-living squeeze that is

still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.

- Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started and will focus on the short, medium and longer end of the curve in equal measure.
- In the upcoming months, the Link forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)
- On the positive side, consumers are still estimated to be sitting on significant excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

#### **PWLB RATES**

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 3.75% to 4.75%.
- Link view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

#### **The balance of risks to the UK economy: -**

- The overall balance of risks to economic growth in the UK is to the downside.

#### **Downside risks to current forecasts for UK gilt yields and PWLB rates include: -**

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).
- **The Bank of England** acts too quickly, or too far, over the coming year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **UK / EU trade arrangements** – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.
- **Geopolitical risks**, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

#### **Upside risks to current forecasts for UK gilt yields and PWLB rates: -**

- **The Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to remain elevated for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate later in the year or in 2024.

- **The pound weakens** because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.
- Longer-term **US treasury yields** rise strongly if inflation remains more stubborn than the market currently anticipates, pulling gilt yields up higher consequently.
- Projected **gilt issuance, inclusive of natural maturities and QT**, could be too much for the markets to comfortably digest without higher yields compensating.

**Borrowing advice:** The Link long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are currently above this level, borrowing strategies will need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed Local Authority to Local Authority monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023.

### 3.5 Borrowing strategy

The factors that influence the 2023-24 strategy are:

- The movement in CFR as set out in Table 3;
- The interest rate forecasts (set out in Table 7);
- Aiming to minimise revenue costs to reduce the impact on the Council Tax Requirement; and
- The impact of the Council's Capital Programme

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need, (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate increases over the first half of 2023.

The Chief Financial Officer has the delegated responsibility to arrange such loans as are legally permitted to meet the Council's borrowing requirement and to arrange terms of all loans to the Council including amounts, periods and rates of interest.

Against this background and the risks within the economic forecast, caution will be adopted with the 2023-24 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in borrowing rates, then borrowing will be postponed.
- if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

At the point of acquiring longer term funding consideration will be given to:

- Whether the forecast capital borrowing requirement has reduced or slipped into the following year.
- The forecast changes to levels of reserves/balances, including whether the Council has received funding in advance of spending for capital schemes.

The strategy is to take longer term fixed rate borrowing when opportunities arise in combination with the temporary use of short-term borrowing as required.

The HRA strategy for borrowing will be the same as the borrowing strategy described above for the whole Council. The HRA Business Plan will guide and influence the overall HRA borrowing strategy.

Any decisions will be reported to the appropriate decision-making body at the earliest opportunity.

### **3.6 Policy on borrowing in advance of need**

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### **3.7 Debt rescheduling**

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a large difference between premature redemption rates and new borrowing rates.

### **3.8 New financial institutions as a source of borrowing and / or types of borrowing**

Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency.
- UK Infrastructure Bank.

Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

### **Approved Sources of Long and Short-term Borrowing**

Table 8 is a new requirement for 2023-24 and shows sources of borrowing that the Council may use and whether the related interest rates are fixed or variable.



**Table 8: Approved sources of long and short term borrowing  
On Balance Sheet**

	<b>Fixed</b>	<b>Variable</b>
PWLB	●	●
UK Municipal Bond Agency	●	●
Local Authorities	●	●
Banks	●	●
Pension Funds	●	●
Insurance Companies	●	●
UK Infrastructure Bank	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock Issues	●	●
Local Temporary	●	●
Local Bonds	●	
Local Authority Bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance Leases	●	●

## 4. ANNUAL INVESTMENT STRATEGY

### 4.1 Investment policy – management of risk

The Department of Levelling Up, Housing and Communities (DLUHC and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with treasury (financial) investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital and Investment Strategies (separate reports that went to full Council 23<sup>rd</sup> February 2023).

The Council’s investment policy has regard to the following: -

- DLUHC’s Guidance on Local Government Investments (“the Guidance”).
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021 (“the Code”).
- CIPFA Treasury Management Guidance Notes 2021.

The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council’s risk appetite. In the current economic climate, it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

The guidance from the DLUHC and CIPFA places a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
2. Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration, the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.
3. Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. This Council has defined the list of types of investment instruments that the treasury management team are authorised to use.
  - Specified investments are those with a high level of credit quality and subject to a maturity limit of one year or have less than a year left to run to maturity if originally they were classified as being non-specified investments solely due to the maturity period exceeding one year.
  - Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments

which require greater consideration by members and officers before being authorised for use.

5. Non-specified and loan investment limits. The Council has determined that it will set a limit to the maximum exposure of the total treasury management investment portfolio to non-specified treasury management investments of £20m.
6. Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.
7. Transaction limits are set for each type of investment in 4.2.
8. This Council will set a limit for its investments which are invested for longer than 365 days, (see paragraph 4.4).
9. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 4.3).
10. This Council has engaged external consultants, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Council in the context of the expected level of cash balances and need for liquidity throughout the year.
11. All investments will be denominated in sterling.
12. As a result of the change in accounting standards for 2022-23 under IFRS 9, this Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the MHCLG, concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years ending 31<sup>st</sup> March 2023.

However, this Council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

## **4.2 Creditworthiness policy**

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose, it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Director of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

The criteria for providing a pool of high-quality investment counterparties, (both specified and non-specified investments) are:

**Table 9: Investment Counterparties**

Institution	Amount	Time limit	To qualify as a "specified investment"	Non-UK Country	Short term Investment rating	Long Term investment rating
Bank /Building Society	£30m	2yrs	Less than 1 year	AA-	Requires if available Fitch F1 S & P A-1 Moody's P-1	Moody's Aa3 or Fitch AA- if not available.
Bank /Building Society	£20m	1yr	Less than 1 year	AA-	Requires if available Fitch F1 S&P A_1 Moody's P_1w	Moody's A1 or Fitch A1 if not available
Bank/Building Society	£7m	100 days	Less than 1 year	AA-	Either F1 or S&P A_1	Either Moody's A1
Nat West Bank	£20m	1yr	Less than 1 year	AA-	Council bank/part Government owned	n/a
Treasury Bill/DMO	No limit	1yr	Less than 1 year		n/a	UK Gov. rating
Money Market Fund	£20m	Instant access	Less than 1 year		n/a	Either Moody's AAA Fitch AAA or S&P AAA
Local Authority	£20m	1yr	Less than 1 year	AA-	n/a	n/a

**Use of additional information other than credit ratings** - Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, rating Watches/Outlooks) will be applied to compare the relative security of differing investment opportunities.

**Creditworthiness** - Significant levels of downgrades to Short- and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. However, as economies are beginning to reopen, there have been some instances of previous lowering of Outlooks being reversed.

**CDS prices** - Although bank CDS prices, (these are market indicators of credit risk), spiked upwards at the end of March / early April 2020 due to the heightened market uncertainty and ensuing liquidity crisis that affected financial markets, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return

in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Council has access to this information via its Link-provided Passport portal.

### 4.3 Other limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

- a) **Non-specified treasury management investment limit.** The Council has determined that it will limit the maximum total exposure of treasury management investments to non-specified treasury management investments as being £20m of the total treasury management investment portfolio.
- b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of A1 for the UK and AA- for the rest of the world from Fitch or equivalent. The list of countries that qualify using these credit criteria as at the date of this report are shown in Appendix 4. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

### 4.4 Investment strategy

**In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e., rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

#### **Investment returns expectations.**

The current forecast shown in paragraph 3.3, includes a forecast for Bank Rate to reach 4.5% in Q2 2023.

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year, are as follows:

**Table 10: Investment earnings rates**

Average earnings in each year	Now
2022-23 (remainder)	4.3%
2023-24	4.3%
2024-25	3.2%
2025-26	2.6%
2026-27	2.5%
Years 6 to 10	2.8%
Years 10+	2.8%

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits, (overnight to 100 days), in order to benefit from the compounding of interest.

**Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council’s liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

The Council is asked to approve the following treasury indicator and limit:

**Table 11: Upper limit for principle sums invested for longer than 365 days**

	<b>2023-24 £m</b>	<b>2024-25 £m</b>	<b>2025-26 £m</b>
Principal sums invested for longer than 365 days	£20m	£20m	£20m
Current investments as at 31-01-2023 in excess of 1 year maturing in each year	£0m	£0m	£0m

#### **4.5 Investment performance / risk benchmarking**

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of overnight, 7 day, compounded/ SONIA. The investment average return up to the end of January was 1.7% with average investment balance of £105m.

#### **4.6 End of year investment report**

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

### **5. Other considerations**

#### **Environmental, Social & Governance (ESG) Considerations**

ESG considerations are becoming an increasingly important topic within the investment community. Whilst around two thirds of Councils have declared a “climate emergency” to date, this has not translated into the incorporation of something more formal within their treasury-related investment strategy. The 2021 changes to the CIPFA Treasury Management Code sees ESG incorporated into Treasury Management Practice (TMP) 1, with the inclusion of the wording, ‘the organisation’s credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations. This is a developing area, and it is not implied that the organisation’s ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level”.

The Council with advice from its treasury advisor, is looking into the impact of including ESG in TMP 1 and must ensure that there is a clear understanding of what “environmental, social and governance (ESG)” investment considerations actually mean, understanding the ESG “risks” that the Council is exposed to and evaluating how well the Council can manage these risks. Members must note that

ESG is not the same as Socially Responsible Investing and not the same as Sustainable Investing (investing in products / companies based on expected sustainable and beneficial societal impact, alongside a financial return).

## **FRS 9 – English Local Authorities**

The former MHCLG now the DLUHC, enacted a statutory over-ride from 1 April 2018 for a five-year period until 31 March 2023 following the introduction of International Financial Reporting Standard (IFRS) 9. The override related to the requirement for any unrealised capital gains or losses on marketable pooled funds to be chargeable in year. This has the effect of allowing any unrealised capital gains or losses arising from qualifying investments to be held on the balance sheet until 31 March 2023. The intention was to allow Authorities to initiate an orderly withdrawal of funds if required, to mitigate any potential impact following the introduction of IFRS 9.

DLUHC launched an 8-week consultation on the future of the IFRS 9 statutory override from 11 August 2022 to 7 October 2022. The aim of this consultation was to collect the views of Authorities and other stakeholders, and to collect additional information needed to understand the financial risks associated with both continuing the statutory override or allowing reversion to the Code of Practice on Local Authority Accounting. The responses to the consultation have now been considered and Ministers have decided to extend the existing IFRS 9 statutory accounting override for a further 2 years until 31 March 2025. DLUHC will publish the Government's full response to the consultation early 2023.

## **6. Financial and Resources Appraisal**

6.1 The financial implications are set out in section 1,2,3 and 4 of this report

## **7. Risk Management and Governance Issues**

7.1 The principal risks associated with treasury management are:

Risk: Loss of investments as a result of failure of counterparties.

Mitigation: Limiting the types of investment instruments used, setting lending criteria for counterparties, and limiting the extent of exposure to individual counterparties.

Risk: That the Council will commit too much of its investments in fixed term investments and might have to recall investments prematurely resulting in possible additional costs or new borrowing (Liquidity risk).

Mitigation: Ensuring that a minimum proportion of investments are held in short term investments for cash flow purposes.

Risk: Increase in the net financing costs of the Council due to borrowing at high rates of interest.

Mitigation: Planning and undertaking borrowing and lending in light of assessments of future interest rate movements, and by undertaking mostly long term borrowing at fixed rates of interest (to reduce the volatility of capital financing costs).

Risk: Higher interest rates increase borrowing making it more difficult to self-finance capital schemes. Debt servicing becomes less affordable and less sustainable and crowds out revenue spend.

Mitigation: To pause, delay or defer capital schemes. Also review opportunities to borrow in the future at current interest rates.

Risk: Return on non-treasury investments lower than expected.

Mitigation: Review and analysis of risk prior to undertaking non-treasury investments.

Risk: The Council's Minimum Revenue Policy charges an insufficient amount to the Revenue Estimates to repay debt.

Mitigation: Align the Minimum Revenue Policy to the service benefit derived from the Council's assets.

Risk: Associated with cash management, legal requirements and fraud.

Mitigation: These risks are managed through:

- Treasury Management Practices covering all aspects of Treasury management procedures including cash flow forecasting, documentation, monitoring, reporting and division of duties.
- All Treasury management procedures and transactions are subject to inspection by internal and external auditors. The council also employs external financial advisors to provide information on market trends, credit rating alerts, lending criteria advice and investment opportunities.

Risk: Anticipated borrowing is lower / higher than expected because the 2023-24 capital programme forecast is incorrect. This is explained in more detail below, together with the actions being taken to reduce these risks:

Mitigation: The Council is required to set a balanced budget for its revenue estimates; so in broad terms, income received will match expenditure over the 2023-24 financial year. The 2023-24 revenue estimates cause only temporary cash flow differences, for example when income is received in a different month to when the expenditure is incurred.

However, the 2023-24 capital budget will cause a cash flow shortfall in the long term, which generates a borrowing requirement. While some of the capital budget is funded immediately, mainly with Government grants, other elements are not funded initially, leading to the cash flow deficit that requires borrowing.

Managing borrowing is part of the Treasury Management role. To help in its management, the Treasury Strategy identifies the element within the capital budget that is not funded straightaway, to anticipate the Council's borrowing requirement.

However, when the capital budget is under / overspent, the Council has a lower / higher borrowing requirement than anticipated. This risk is managed in practice because the Council only borrows when there is an actual cash flow shortage. The uncertainty around spend against the capital budget makes cash flow management more difficult. For example, it is less likely that the Council would take advantage of a short-term fall in interest rates, without more certainty around the timing of any borrowing need. Actions that have taken place to manage the risks relating to this uncertainty in the timing of capital spend are: Councillor and Officer challenge sessions on the capital budget; increased scrutiny of the capital forecasts in the quarterly monitoring, and the collection of additional documentation around the critical paths of individual schemes.

## **8. Legal Appraisal**

8.1 Any relevant legal considerations are set out in the report.

## **9. Other Implications**

9.1 Equality & Diversity – no direct implications



- 9.2 Sustainability implications – no direct implications
- 9.3 Green house Gas Emissions Impact – no direct implications
- 9.4 Community safety implications – no direct implications
- 9.5 Human Rights Act – no direct implications
- 9.6 Trade Unions – no direct implications
- 9.7 Ward Implications – no direct implications
- 9.8 Implication for Corporate Parenting – no direct implications
- 9.9 Issues arising from Privacy Impact Assessment– no direct implications

## **10. Not for publications documents**

- 10.1 None

## **11. Options**

- 11.1 None

## **12. Recommendations**

- 12.1 That the report be noted by the Governance and Audit Committee and passed to full Council for adoption.

## **11. Appendices**

- Appendix 1 Prudential and Treasury Indicators
- Appendix 2 Minimum Revenue Provision (MRP) Policy
- Appendix 3 Economic Background
- Appendix 4 Approved countries for investments
- Appendix 5 Treasury Management scheme of delegation
- Appendix 6 Treasury Management role of the Statutory Chief Finance Officer (Director of Finance)

## Appendix 1

### THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2022-23 – 2026-27

To facilitate the decision making process and support capital investment decisions, the Prudential Code requires the Council to approve and monitor a minimum number of prudential indicators. These indicators are mandatory and cover affordability, prudence, capital expenditure, external debt and treasury management.

The indicators are purely for internal use by the Council and are not intended to be used as comparators between councils. In addition to this in-year indication, the benefit from monitoring arises from following the movement in indicators over time and the year-on-year changes.

#### Capital expenditure

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital expenditure	2021-22 Actual £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m	2026-27 Estimate £m
General Fund	-	-	232	203	76	134
HRA	-	-	5	10	10	4
<b>Total</b>	<b>104</b>	<b>191</b>	<b>237</b>	<b>213</b>	<b>86</b>	<b>138</b>

\*Separate HRA only applies from 01-04-2023

#### Estimates of Capital Financing Requirement

	2021-22 Actual £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m	2026-27 Estimate £m
<b>Opening Capital Financing Requirement</b>	<b>699</b>	<b>709</b>	<b>773</b>	<b>854</b>	<b>920</b>	<b>930</b>
Increase in borrowing	35	83	104	92	38	60
Less MRP and other financing movements	-25	-19	-23	-26	-28	-29
<b>Closing Capital Financing Requirement</b>	<b>709</b>	<b>773</b>	<b>854</b>	<b>920</b>	<b>930</b>	<b>961</b>

#### Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

##### a. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital, (borrowing and other long-term obligation costs net of investment income), against the net revenue stream.

	2022-23	2023-24	2024-25	2025-26	2026-27
	£m	£m	£m	£m	£m
MRP, excluding PFI	16.1	19.8	22.7	24.4	25.7
MRP PFI, finance lease	3.4	3.4	3.5	3.6	3.6
Old West Yorkshire Waste debt	0.2	0.2	0.2	0.2	0.2
Interest on external borrowing	16.6	18.4	23.7	24.3	24.8
Interest on PFI	15.9	15.3	14.6	14.0	13.2
Premium on debt repayment	0.3	0.3	0.3	0.3	0.3
<b>Total Capital Financing Costs</b>	<b>52.5</b>	<b>57.4</b>	<b>65.0</b>	<b>66.6</b>	<b>67.7</b>
Projected Net Revenue Stream	388.0	441.0	441.0	441.0	441.0
<b>Ratio to Net Revenue Stream</b>	<b>13.5%</b>	<b>13.0%</b>	<b>14.7%</b>	<b>15.1%</b>	<b>15.4%</b>
Invest to Save element of Total Capital Financing Costs	6.3	6.5	7.7	7.9	8.4
Invest to Save contribution to Ratio to Net Revenue Stream	<b>1.6%</b>	<b>1.5 %</b>	<b>1.6%</b>	<b>1.8%</b>	<b>1.9%</b>

### Prudence indicators

- Gross debt and the capital financing requirement

The Prudential Code requires the calculation of the capital financing requirement (CFR). This figure represents the Council's underlying need to borrow for a capital purpose and the change year-on-year will be influenced by the capital expenditure in the year.

In order to ensure that over the medium term gross debt will only be for capital purposes, the Council must ensure that gross debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. In cases where the CFR is reducing over the period, the Code allows the CFR at its highest point to be used in this calculation.

The Council had no difficulty meeting the previous calculation in 2021-22, nor are any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this budget report and is shown in the table below.

	2021-22 Actual £m	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m	2026-27 Estimate £m
<b>External Debt</b>						
Debt at 1 April	334.4	371.1	455.0	546.0	641.0	663.0
Expected change in Debt	36.7	83.9	91.0	95.0	22.0	51.0
Other long-term liabilities (OLTL)	154.9	146.9	139.0	130.5	121.9	111.0
Expected change in OLTL	-8.0	-7.9	-8.5	-8.6	-9.9	-10.5
Actual gross debt at 31 March	<b>519.6</b>	<b>594.0</b>	<b>676.5</b>	<b>762.9</b>	<b>775.0</b>	<b>815.5</b>

The Capital Financing Requirement	<b>709.2</b>	<b>773.0</b>	<b>854.0</b>	<b>920.0</b>	<b>930.0</b>	<b>961.0</b>
Under / (over) borrowing	<b>189.6</b>	<b>179.0</b>	<b>177.5</b>	<b>157.1</b>	<b>155.0</b>	<b>145.5</b>

### External debt indicators

#### Operational boundary

	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m	2026-27 Estimate £m
Total	840	860	930	940	970

#### Authorised limit

	2022-23 Estimate £m	2023-24 Estimate £m	2024-25 Estimate £m	2025-26 Estimate £m	2026-27 Estimate £m
Total	860	880	950	960	990

Actual external debt as at 31st March - this will be reported within the outturn report on treasury management.

### Maturity structure of borrowing

These gross limits are set to reduce the Council's exposure to large, fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

<b>Maturity structure of fixed interest rate borrowing 2023-24</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	20%
12 months to 2 years	0%	20%
2 years to 5 years	0%	50%
5 years to 10 years	0%	50%
10 years to 20 years	0%	90%
20 years to 30 years	20%	90%
30 years to 40 years	20%	90%
40 years to 50 years	20%	90%

<b>Maturity structure of variable interest rate borrowing 2023-24</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	20%
12 months to 2 years	0%	20%
2 years to 5 years	0%	20%
5 years to 10 years	0%	20%
10 years and over	0%	20%

### Upper limit for principle sums invested

Total principal sums invested for periods longer than 365 days – if the Council invests or plans to invest for longer than 365 days it must set an upper limit for each financial year for the maturing of such investments.

£m	2022-23 £m	2023-24 £m	2024-25 £m
Principal sums invested for longer than 365 days	£20m	£20m	£20m

### **Control of interest rate exposure**

Members are advised that indicators for interest rate exposure are no longer a requirement under the new Treasury Management Code. However, as interest rate exposure risk is an important issue, officers will continue to monitor the balance between fixed and variable interest rates for borrowing and investments. This will aim to ensure the Council is not exposed to adverse fluctuations in fixed or variable rate interest rate movements.

This is likely to reflect higher fixed interest rate borrowing if the borrowing need is high or fixed interest rates are likely to increase, or a higher variable rate exposure if fixed interest rates are expected to fall. Conversely if shorter term interest rates are likely to fall, investments may be fixed earlier, or kept shorter if short term investments are expected to rise.

The balance between variable rate debt and variable rate investments will be monitored as part of the overall treasury function in the context of the overall financial instruments structure and any under or over borrowing positions.

## Appendix 2

### MRP Policy

1.1 The Local Government Act 2003 requires the Council to make a provision for the repayment of borrowing used to finance its capital expenditure, known as the Minimum Revenue Provision (MRP).

1.2 The MRP is the amount of principal capital repayment that is set aside each year in order to repay the Capital Financing Requirement (CFR) based on the requirement of statutory regulation and the Council's own accounting policies.

1.3 The Council is required to state as part of its budget process the policy for determining its MRP. The method for calculating the MRP on each category of debt is outlined below:

a) From 1 April 2022 the policy for charging MRP on historic supported borrowing is on the annuity asset life method calculated over the remaining 36 years.

b) Unsupported or prudential borrowing MRP is based on the Asset Life method – that is, the expenditure financed from borrowing is divided by the expected asset life. From 1 April 2022 the MRP is calculated on the annuity basis.

c) Since 2009-10 the appropriate financing costs for the Council's Building Schools for the Future (BSF) Private Finance Initiative (PFI) schemes have been included in MRP calculations. In 2018-19 the MRP policy for PFI assets was brought into line with the main MRP Policy and the charge of the principal to the revenue account is now over the life of the school building assets. As per the main borrowing from the 1 April 2022 this is on an annuity asset life basis.

d) Finance lease MRP is equal to the principal repayment.

e) Asset lives are reviewed on an ongoing basis to match the MRP charge to the Revenue Estimates with the service benefit derived from the asset.

f) Where the Council has made property investments [or an invest to save investment] during or after 2018-19, the Section 151 Officer may choose to repay debt over the asset life using the annuity method. This is subject to an in house valuation that the investment property has retained or increased in value. Further it is subject to the condition that the in-year yield is above the average for Treasury Investments and this is expected to continue into the future.

g) Where capital expenditure involves repayable loans or grants to third parties no MRP is required where the loan or grant is repayable. By exception, on the basis of a business case and risk assessment, this approach may be amended at the discretion of the Director of Finance.

1.4 The CFR represents the amount of capital expenditure that has been financed from borrowing, less any amounts that the Council has set aside to repay that debt through the MRP. Borrowing may come from loans taken from the Public Works Loan Board (PWL) or commercial banks, finance leases (including PFI) or from the use of the Council's own cash balances.

1.5 External debt can be less than the CFR. External debt cannot exceed the CFR (other than for short term cash flow purposes or cash flow management.)

1.6 There is an International Financial Reporting Standards requirement that assets funded from finance leases (including PFI deals) are brought onto the balance sheet. This also includes the liability as well as the asset. Therefore, the term borrowing does not just include loans from the Public Works Loan Board and banks, but also the liability implicit in PFI and other finance leases. IFRS 16 is due to be implemented from the 1 April 2024 and as a result, more of the Council's leases will be treated as finance leases. Therefore, more of the costs of these leases will be included in capital financing costs for the purposes of calculating the Prudential Indicator.

1.7 The CIP will need to be reviewed through the planning cycle to ensure it remains affordable within revenue resources and to take account of the actual implementation of capital schemes.

1.8 Loans to third parties for a capital purpose can be repaid with the repayments providing the following conditions are met: the capital scheme is self-financing; that there is overall confidence that the loan will be repaid; that the third party adheres to the agreed repayment schedule.

### Appendix 3 Economic Background (provided by Link Group)

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps in 2022. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
<b>Bank Rate</b>	4.0%	2.5%	4.5%-4.75%
<b>GDP</b>	-0.3%q/q Q3 (1.9%y/y)	+0.3%q/q Q3 (2.3%y/y)	2.9% Q4 Annualised
<b>Inflation</b>	10.5%y/y (Dec)	8.5%y/y (Jan)	6.5%y/y (Dec)
<b>Unemployment Rate</b>	3.7% (Nov)	6.6% (Dec)	3.5% (Dec)

Q2 of 2022 saw UK GDP revised upwards to +0.2% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Nevertheless, CPI inflation picked up to what should be a peak reading of 11.1% in October, although with further increases in the gas and electricity price caps pencilled in for April 2023, and the cap potentially rising from an average of £2,500 to £3,000 per household, there is still a possibility that inflation will face some further upward pressures before dropping back slowly through 2023 to finish the year in the range of 4% - 5%.

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as long-term sick, the UK labour force actually shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22 February 2022.

Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3.5% in December and 4% in February and the market currently expects Bank Rate to hit 4.5% by June 2023.

Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17<sup>th</sup> November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

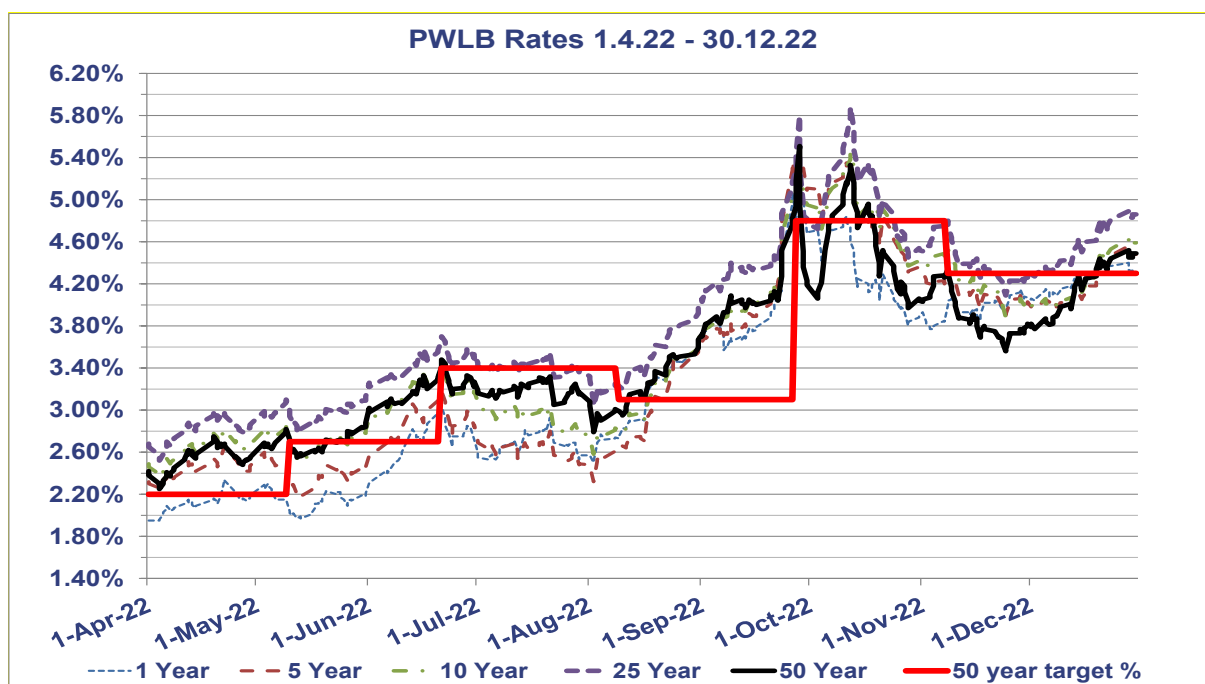
Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point to at least one, if not more, quarters of GDP contraction in 2023. In November, the MPC



projected eight quarters of negative growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank. Indeed, their February Monetary Policy Report suggests five quarters of negative growth, albeit a shallow recession with GDP expected to shrink 0.5% in 2023 and 0.25% in 2024.

The £ has remained resilient of late, recovering from a record low of \$1.035, on the Monday following the Truss government's "fiscal event", to \$1.22. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first nine months of 2022/23 is clear to see.



However, the peak in rates on 28<sup>th</sup> September as illustrated in the table covering April to December 2022 below, has been followed by the whole curve shifting lower. PWLB rates at the front end of the curve are generally over 1.25% lower now whilst the 50 years is also over 1% lower.

#### HIGH/LOW/AVERAGE PWLB RATES FOR 01.04.22 – 30.12.22

	1 Year	5 Year	10 Year	25 Year	50 Year
<b>Low</b>	1.95%	2.18%	2.36%	2.52%	2.25%
<b>Date</b>	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
<b>High</b>	5.11%	5.44%	5.45%	5.88%	5.51%
<b>Date</b>	28/09/2022	28/09/2022	12/10/2022	12/10/2022	28/09/2022
<b>Average</b>	3.26%	3.41%	3.57%	3.85%	3.51%
<b>Spread</b>	3.16%	3.26%	3.09%	3.36%	3.26%

The S&P 500 and FTSE 100 have climbed in the early weeks of 2023, albeit the former finished 19% down in 2022 whilst the latter finished up 1%.

## **CENTRAL BANK CONCERNS – DECEMBER 2022 & FEBRUARY 2023**

In December, the Fed decided to push up US rates by 0.5% to a range of 4.25% to 4.5%, whilst the MPC followed by raising Bank Rate from 3% to 3.5%, in line with market expectations. EZ rates have also increased to 2% with further tightening in the pipeline.

Having said that, the sentiment expressed in the press conferences in the US and the UK were very different. In the US, Fed Chair, Jerome Powell, stated that rates will be elevated and stay higher for longer than markets had expected. Governor Bailey, here in the UK, said the opposite and explained that the two economies are positioned very differently so you should not, therefore, expect the same policy or messaging.

At the start of February, US rates have further increased by 0.25% to a range of 4.5% - 4.75%, whilst UK Bank Rate increased 0.5% to 4%.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.25% - 4.5%, caution is advised as the Bank of England Quarterly Monetary Policy Reports have carried a dovish message over the course of the last year, only for the Bank to have to play catch-up as the inflationary data and labour market have proven stronger than expected.

In addition, the Bank's central message that GDP will fall for five quarters starting with Q1 2023 may prove to be a little pessimistic. Will the excess savings accumulated by households through the Covid lockdowns provide a spending buffer for the economy – at least to a degree? Ultimately, however, it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).

## Appendix 4

### APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P)

#### *Based on lowest available rating*

##### AAA

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

##### AA+

- Canada
- Finland
- U.S.A.

##### AA

- France

##### AA-

- Belgium
- Hong Kong
- Qatar
- **U.K.**

## **Appendix 5 TREASURY MANAGEMENT SCHEME OF DELEGATION**

### **(i) Full Council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

### **(ii) Governance and Audit Committee**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

### **(iii) Corporate Overview and Scrutiny Committee**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

## **Appendix 6 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER**

### **The S151 (responsible) officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

The above list of specific responsibilities of the S151 officer in the 2021 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management). These include:

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe.
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money.
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Council.
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing.
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the Council to an excessive level of risk compared to its financial resources.
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities.
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees.
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority.
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above.
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following -
  - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
  - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;

- Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
- Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
- Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.